

Options Greeks: The Theta

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General

- The options theta is a measurement of the option's time decay.
- The theta measures the rate at which options lose their value, specifically the time value, as the expiration date gets closer.
- Generally expressed as a negative number, the theta of an option reflects the amount by which the option's value will decrease every day.
- In other words, an option premium that is not intrinsic value will decline at an increasing rate as expiration nears.

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Negative vs. positive theta

- Theta values are negative in long option positions and positive in short option positions.
- Initially, out of the money options have a faster rate of theta decay than at the money options, but as expiration nears, the ATM options begin to accelerate at a faster rate.
- Theta is often called a "silent killer" of option buyers. Buyers have only limited risk in their strategies together with the potential for unlimited gains.
- It is true you can only lose what you pay for an option, but there is also no limit how many times you can lose.

Negative vs. positive theta (cont.)

- When buying options, you can reduce the risk of negative theta by buying options with longer expiration. The tradeoff is smaller positive gamma, which means that the gains will be smaller if the stock moves.
- The same is true of credit spreads, which are really selling strategies.
- Calendar spreads involve buying a longer-dated option and selling a nearer-dated option, taking advantage of the fact that options expire faster as they approach expiration.
- As a general rule of thumb, option sellers want the underlying to stay stable, while option buyers want it to move.

List of theta positive strategies

- Short Call
- Short Put
- Short Straddle
- Short Strangle
- Covered Call Write
- Covered Put Write
- Long Calendar Spread
- Vertical Credit Spread
- Iron Condor
- Butterfly

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List of theta negative strategies

- Long Call
- Long Put
- Long Straddle
- Long Strangle
- Vertical Debit Spread